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EXDIS-MIL ADDEE HANDLE AS SPECAT EXCLUSIVE

FOR ASSISTANT SECRETARY ROGERS

FOLLOWING REPEAT FROM AMERICAN EMBASSY CARACAS 8696

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C O N F I D E N T I A L CARACAS 8696

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FOR ASSISTANT SECRETARY ROGERS

EO 11652: GDS

TAGS: ENRG VE

SUBJ: PETROLEUM REVERSION - STATUS AND EMBASSY ESTIMATE

1. SUMMARY: THE OIL COMPANIES, OR AT LEAST THEIR REPRESENTATIVES
HERE, REGARD EFFECTIVE COMPENSATION FOR NATIONALIZATION AS THE SUM
OF WHATEVER TOTAL PACKAGES THEY ARE ABLE TO NEGOTIATE
WITH THE GOV, NOT JUST THE AMOUNT TO BE PAID FOR THE NET BOOK VALUE
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OF PHYSICAL ASSETS. INCLUDED WOULD BE ACCESS TO OIL AND PAYMENT FOR
TECHNICAL SERVICES. THE NEGOTIATIONS WITH CREOLE, NOW WELL UNDER
WAY, WILL SET THE PATTERN FOR THE REST OF THE CONCESSIONAIRES.
BECAUSE OF THE 45-DAY TIME LIMIT ON OFFERS OF COMPENSATION, ALL THE

NEGOTIATIONS WILL PROBABLY HAVE TO BE CONCLUDED IN THE NEXT 60 DAYS OR SO--AND CLEARLY BEFORE THE END OF NOVEMBER. A NUMBER OF PROBLEMS IN THE LEGISLATION WILL REQUIRE DIFFICULT DECISIONS ON THE PART OF PRESIDENT PEREZ AT CONSIDERABLE POLITICAL RISK IF ACCOMODATIONS ARE TO BE REACHED WITH THE COMPANIES. THE POLITICAL ATMOSPHERE ALSO DEMANDS DISCRETION AND PRAGMATISM ON BOTH SIDES. WE ESTIMATE THE CURRENT ODDS AS AT LEAST EVEN THAT CREOLE WILL STRIKE A BARGAIN AND THAT THE LARGER CONCESSIONAIRES WILL FOLLOW ALONG. THE ACTIONS THE SMALLER PRODUCERS WOULD THEN TAKE ARE MOST DIFFICULT TO PREDICT GIVEN THEIR VARYING INDIVIDUAL CIRCUMSTANCES. WE CONCLUDE THAT AT THIS STAGE, AS CREOLE AND THE GOV GET DOWN TO HARD BARGAINING, THE PRUDENT COURSE FOR THE USG IS TO CONTINUE THE ATTITUDE OF WATCHFUL WAITING. END SUMMARY.

2. THIS TELEGRAM IS BASED ON PROPRIETARY INFORMATION GIVEN TO THE EMBASSY IN CONFIDENCE BY THE REPRESENTATIVES OF AMERICAN COMPANIES AND NOT FOR DISSEMINATION TO THIRD PARTIES.

3. IN SEPARATE MESSAGES WE ARE PROVIDING REPORTS ON THE REVERSION PROCESS AS SEEN BY CREOLE, MENE GRANDE, SHELL, MOBIL, TEXACO AND SUN. WHILE THE GOV CONTINUES TO TALK TO THE BIGGER CONCESSIONAIRES ON A REGULAR BASIS, AND TO THE SMALLER COMPANIES OCCASIONALLY, IT IS CLEAR THAT THE BASIC NEGOTIATIONS UNDERWAY NOW ARE WITH CREOLE. THE APPARENT GOV PLAN FROM THE OUTSET HAS BEEN TO REACH AGREEMENT FIRST WITH THE LARGEST CONCESSIONAIRE AND TO USE THAT AGREEMENT AS A PATTERN FOR SETTLEMENT WITH THE OTHER COMPANIES. CREOLE HAS NOW SUBMITTED DETAILED PROPOSALS WITH AT LEAST SOME OF THE NUMBERS ATTACHED. THE PROSPECTS FOR THESE NEGOTIATIONS SHOULD BE FAIRLY CLEAR WITHIN THE NEXT FEW WEEKS.

4. ALL OF THE COMPANIES WE HAVE BEEN IN CONTACT WITH TAKE THE SAME BASIC PACKAGE APPROACH TO NATIONALIZATION AS DOES CREOLE. THEY REGARD EFFECTIVE COMPENSATION AS THE SUM OF SEVERAL FACTORS AND NOT JUST THE AMOUNT TO BE RECEIVED UNDER ARTICLE 15 OF THE DRAFT LEGISLATION. AS IN THE CASE OF CREOLE, THEY SEE THE PACKAGE AS MADE UP OF REIMBURSEMENT FOR TECHNICAL SERVICES AND ACCESS TO OIL AT FAVORABLE PRICES, IN ADDITION TO THE STIPULATED PAYMENT
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FOR PROPERTIES, PLANT AND EQUIPMENT ON THE BASIS OF NET BOOK VALUE. EMPHASIS ON THE RELATIVE IMPORTANCE OF ONE OR THE OTHER OF THESE THREE "LEGS" VARIES WITH THE INDIVIDUAL INTERESTS OF THE COMPANIES, BUT ALL HOPE TO MAKE UP ANY SHORTFALL ON STRAIGHT COMPENSATION THROUGH FUTURE PROFITS IN ONE OF THE OTHER SECTORS.

5. THE COMPANIES ALSO AGREE (AS WE DO) THAT CARLOS ANDRES PEREZ WANTS AS LITTLE CHANGE IN THE STRUCTURE OF THE INDUSTRY AS POSSIBLE. THE GOV PLAN IS THAT THE COMPANIES WILL CONTINUE JUST AS THEY ARE FOR THE TIME BEING, ALTHOUGH PRESUMABLY UNDER DIFFERENT NAMES AND WITH VENEZUELAN OCCUPYING THE PRESIDENCIES. (THE COMPANIES WOULD "RENT" THEIR KEY FOREIGN TECHNICIANS TO THE NEW VENEZUELAN COMPANIES AS PART OF THEIR SERVICES

AGREEMENTS.) THIS SITUATION GIVES AT LEAST THE MAJOR CONCESSIONAIRES CONSIDERABLE LEVERAGE. THE GOV MUST HAVE ACCESS TO THEIR MARKETING NETWORKS, SPECIALIZED PERSONNEL AND TECHNOLOGICAL SUPPORT IF SERIOUS DISRUPTION IS TO BE AVOIDED. EVEN THE SMALLER OPERATORS ARE NOT WITHOUT BARGAINING COUNTERS SINCE THE PRESIDENT SEEKS TO KEEP EACH AND EVERY PIECE IN PLACE.

6. THE CRITICAL MOMENT IN THE PROCESS IS FAST APPROACHING. THE REVERSION LEGISLATION WILL EMERGE FROM THE CONGRESS WITHIN THE NEXT FEW DAYS. THE PRESIDENT HAS TEN DAYS TO SIGN IT. (SEPTEMBER 2 HAD BEEN THE RUMORED DATE, BUT THE BILL HAS NOW BEEN MODIFIED TO SET NATIONALIZATION FOR JANUARY 1, 1976 RATHER THAN 120 DAYS AFTER SIGNING. THE NECESSITY TO PUT BACK THE SIGNING DATE MAY THEREFORE HAVE DISAPPEARED.) WITHIN 45 DAYS AFTER THE BILL BECOMES LAW THE MINISTRY OF MINES MUST PRESENT FORMAL OFFERS OF COMPENSATION (ARTICLE 12). EACH COMPANY MUST RESPOND WITHIN 15 DAYS AFTER RECEIVING ITS OFFER. NO COMPANY WILL WISH TO RESPOND, ACCEPTING OR REJECTING AN OFFER, UNLESS THE OTHER PARTS OF ITS PACKAGE HAVE ALREADY BEEN NEGOTIATED. IN THE EVENT OF NO RESPONSE, ANOTHER 30 DAYS WILL THEORETICALLY BE AVAILABLE FOR NEGOTIATIONS IN ACCORDANCE WITH ARTICLE 12. THUS, THE END OF NOVEMBER WOULD APPEAR TO BE THE OUTER LIMIT FOR THE CONCLUSION OF NEGOTIATIONS WITH ALL THE COMPANIES. THE MINISTER OF MINES IS QUITE AWARE OF THIS TIME CONSTRAINT AND IS THUS UNDER PRESSURE TO MOVE THE CREOLE TALKS ALONG AND ESTABLISH THE PATTEVN.

7. THE LEGISLATION RAISES SEVERAL IMMEDIATE NEGOTIATING QUESTIONS:

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--HOW WILL THE GOV HANDLE THE PROBLEM OF DEPOSITS TO THE GUARANTY FUND? THE GOV IS CONSIDERING PERMITTING THE COMPANIES TO OFFSET THE DEPOSIT IN COMPENSATION BONDS AND HAS SO PROVIDED IN ARTICLE 19 OF THE REVERSION LAW, BUT IT IS NOT CLEAR TO US HOW THAT WOULD WORK IN LIGHT OF THE SPECIFIC REQUIREMENT FOR PAYMENT TO THE DEPOSIT FUND WITHIN 30 DAYS OF PROMULGATION OF THE LAW--OR PRESUMABLY BEFORE THE COMPENSATION OFFERS COULD BE TENDERED AND ACCEPTED. THE COMPANIES WILL STRONGLY RESIST ANY ATTEMPT TO REQUIRE CASH DEPOSITS.

--WHAT KIND OF TERM AND INTEREST RATE WILL APPLY TO THE COMPENSATION BONDS? GOV AGREEMENT TO REDEEM THE BONDS IN OIL OVER A REASONABLY SHORT PERIOD IS AN IDEA ATTRACTIVE TO THE COMPANIES BUT WILL NOT BE AN EASY PROPOSITION TO SELL POLITICALLY.

--HOW ACCOMMODATING WILL THE GOV BE ON THE QUESTION OF WHAT CONSTITUTES REVERTIBLE PROPERTY? SEVERAL COMPANIES HOLD LAND AND/OR BUILDINGS IN SEPARATE SUBSIDIARIES UNRELATED TO THEIR PETROLEUM FUNCTIONS.

--WHAT DOES THE GOV INTEND WITH RESPECT TO ENFORCEMENT OF THE DRAINAGE PROVISION? A FEW COMPANIES--MOBIL, SUN, TEXACO AND

PHILLIPS-' SIGNIFICANTLY AFFECTED BY THE UNITIZATION
ISSUE. THE MINISTRY INSISTS IN PRIVATE THAT THE QUESTION WILL BE
SETTLED ON STRICTLY TECHNICAL GROUNDS. AS WE UNDERSTAND IT, THE
COMPANIES HAVE A GOOD TECHNICAL CASE FOR ASSERTING THAT IN
ALMOST EVERY INSTANCE THE RESERVOIRS CONTAIN SUFFICIENT OIL TO
COMPENSATE CVP FULLY, EVEN WHEN THE CALCULATION IS MADE ON
THE THEORETICAL BASIS OF CONTINUING PARTICIPATION BY THE U.S.
COMPANIES DURING ALL THE YEARS OF THE CONCESSIONS AS ORIGINALLY
GRANTED. (ADDITIONAL PROBLEMS IN INDIVIDUAL CASES PROMISE
HEAVY GOING. THE QUESTION OF COMPENSATION FOR THE SERVICE
CONTRACTS OF MOBIL AND OCCIDENTAL LOOKS PARTICULARLY DIFFICULT.)

8. THE OTHER "LEGS OF THE STOOL"--TECHNICAL SERVICES AND ACCESS
TO OIL--ARE BEING NEGOTIATED ACTIVELY WITH CREOLE. THE RISK HERE
IS THAT THE SMALLER CONCESSIONAIRES MAY NOT FIND THE CREOLE
PACKAGE ATTRACTIVE. THAT COMPANY, FOR EXAMPLE, SEES THE
TECHNICAL SERVICES SECTOR AS A PROMISING SOURCE OF FUTURE PROFIT.
IT HAS THE ORGANIZATION, THE PEOPLE AND THE EXPERIENCE THAT PETROVEN
WILL REQUIRE. OTHER COMPANIES MAY WELL HAVE BETTER USES FOR
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THEIR MORE RESTRICTED HUMAN AND TECHNOLOGICAL RESOURCES.
HOWEVER, CREOLE GIVES EVERY EVIDENCE OF BEING DETERMINED TO
STRIKE A HARD BARGAIN--AND SUCCESS IN THAT ENDEAVOR COULD GIVE
EVERYONE ELSE MORE ROOM TO MANEUVER.

9. THE NARROWER ISSUES POSED BY THE LANGUAGE OF THE LEGISLATION
AS WELL AS THE BROADER QUESTIONS RELATING TO THE TERMS OF VENEZUELA'S
FUTURE RELATIONSHIP WITH THE COMPANIES ALL RAISE THE SAME QUESTION;
WILL THE GOV (OR MORE SPECIFICALLY VALENTIN HERNANDEZ AND THE
PRESIDENT) HAVE THE POLITICAL WILL NECESSARY TO REACH PRACTICAL
ACCOMMODATIONS? COPEI AND THE LEFT CAN BE COUNTED ON TO SUBJECT
EACH AND EVERY AGREEMENT TO THE MOST SEARCHING SCRUTINY.
EX-PRESIDENT CALDERA HAS SET A PREVAILING POLITICAL TONE WITH HIS
ASSAULT ON THE COMPANIES (CARACAS 8105). THE PRESIDENT'S FEARS
OF CONGRESSIONAL REACTION HAVE REPORTEDLY PREVENTED HIM FROM
PROPOSING SEVERAL SENSIBLE CHANGES IN THE LAW, SUCH AS AN
APPROPRIATE MODIFICATION TO ARTICLE 15 (B). THE ESSENTIAL INGREDIENT
WILL BE STRONG PRESIDENTIAL DETERMINATION TO SERVE THE COUNTRY'S
LONGER RANGE INTERESTS AT THE RISK OF IMMEDIATE POLITICAL COST.

10. BOTH SIDES MUST MANEUVER CAREFULLY IN THIS DELICATE SITUATION.
A PARTICULAR CONSTRAINT ON BOTH IS THE ABSOLUTE NECESSITY TO AVOID
ANY APPEARANCE OF ATTEMPTING TO CIRCUMVENT THE LETTER AND INTENT
OF THE REVERSION LEGISLATION. NATIONALIZATION HAS BEEN ADVERTISED
ON ALL SIDES HERE AS A CONSTITUTIONAL PROCESS TO BE CARRIED OUT
UNDER THE LAW--A LAW MORE THOROUGHLY AIDED AND PUBLICLY
DEBATED THAN PERHAPS ANY IN VENEZUELA'S HISTORY. THE MARXISTS
AND THEIR ALLIES WHO ADVOCATE "INTEGRAL NATIONALIZATION" (WHICH
ESSENTIALLY MEANS EVICTION OF THE COMPANIES WITH MINIMAL
COMPENSATION) ARE FULLY CAPABLE IN THE CURRENT ENVIRONMENT
OF CREATING A POLITICAL STORM OVER EVASION OF THE PEOPLE'S WILL

IF THE NEGOTIATIONS SEEM TO BE DOING LESS THAN MEETING THE LAW'S FULL BILL OF PARTICULARS. THAT KIND OF A STORM COULD WIPE OUT THE GOV'S FLEXIBILITY AND PUT AN END TO ANY PROSPECT FOR ACCEPTABLE PACKAGE ARRANGEMENTS.

11. THE COMPANIES HAVE RECOGNIZED THSE REALITIES IN ADOPTING THE PACKAGE APPROACH. THEY APPEAR PREPARED TO FOLLOW CREOLE'S LEAD IN NEGOTIATING FROM THE BASE LINE OF COMPENSATION FOR NET BOOK VALUE IN THE HOPES OF OBTAINING LARGER ULTIMATE PAYOFFS ELSEWHERE. THEIR ALTERNATIVE WOULD BE TO REJECT THE CONCEPTUAL CONFIDENTIAL

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FRAMEWORK OF THE REVERSION LEGISLATION, INSIST ON BROADER STANDARDS OF COMPENSATION (INCLUDING PAYMENT FOR THE VALUE OF THE CONCESSIONS) AND CHALLENGE THE CONSTITUTIONALITY OF THE LAW IN THE SUPREME COURT. A SUCCESSFUL OUTCOME WOULD SEEM MOST IMPROBABLE. THE COROLLARY RESULT WOULD BE COURT-DIRECTED EXPROPRIATION IN ACCORDANCE WITH ARTICLES 13 AND 14 OF THE REVERSION LAW. NONE OF THE COMPANY OFFICERS WE HAVE SPOKEN TO HERE THINKS THAT ROUTE WOULD PRODUCE MORE THAN MINIMAL COMPENSATION. ON THE OTHER HAND, WAITING FOR CREOLE DOES NOT APPEAR TO RISK ANY COMAPNY'S LEGAL POSITION. NO ONE IS COMPROMISED UNTIL HE ACCEPTS THE OFFER TENDERED BY THE MINISTRY UNDER ARTICLE 15.

12. IT IS DIFFICULT TO FORESEE HOW THIS COMPLICATED PROCESS WILL COME OUT. AT THE MOMENT, THE ODDS ARE AT LEAST EVEN THAT CREOLE WILL STRIKE A DEAL. IF THAT HAPPENS, THE LARGER CONCESSIONAIRES ARE ALSO LIKELY IN OUR JUDGEMENT TO REACH AGREEMENT. THE DECISIONS THE SMALLER PRODUCERS MIGHT THEN TAKE ARE MOST DIFFICULT TO ANTICIPATE. MUCH WOULD DEPEND ON INDIVIDUAL CIRCUMSTANCES AND HOW ONE PEERS INTO THE MURKY FUTURE OF VENEZUELAN PETROLEUM. SOME MAY ULTIMATELY CHOOSE TO ACCEPT WHAT THEY CAN GET AND LEAVE; AND OTHERS MAY ELECT TO GO TO COURT WITH AN EYE TO EVENTUAL USG REPRESENTATIONS.

13. WE CONCLUDE THAT THE USG SHOULD MAINTAIN THE ATTITUDE OF WATCHFUL WAITING, AT LEAST UNTIL WE KNOW THE FATE OF CREOLE'S PACKAGE. THE PRESIDENT AND HIS COLLEAGUES ARE SKITTISH ENOUGH AS IT IS. ANY SUGGESTION OF PRESSURE ON OUR PART, EITHER DIRECT OR THROUGH THE COMPANIES, WOULD RISK THE KIND OF PRECIPITANT OVERREACTION WE HAVE SEEN ON THE PART OF CARLOS ANDRES PEREZ IN OTHER SITUATIONS AND COULD JEOPARDIZE CREOLE'S POSITION. CREOLE HAS THE LEVERAGE IT NEEDS TO NEGOTIATE IF THE ATMOSPHERE IS SUITABLE CALM AND PRAGMATIC. I HAVE TRIED TO MAKE CLEAR TO THE PRESIDENT, THE MINISTER OF MINES AND THE FOREIGN MINISTER THAT THE USG IS CONCERNED THAT THE COMPANIES RECEIVE FAIR COMPENSATION. WE CAN BEST MAINTAIN THAT BASIC POSITION, WHILE FORECLOSING NO OPTIONS, BY STANDING ASIDE AND LETTING THE NEGOTIATORS NEGOTIATE.

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